

T-2202



**U.S. Department of the Interior
Office of Inspector General**

**INDEPENDENT AUDITORS' REPORT
ON THE TRIBAL AND OTHER TRUST FUNDS
AND INDIVIDUAL INDIAN MONIES TRUST FUNDS
FINANCIAL STATEMENTS FOR
FISCAL YEARS 2004 AND 2003
MANAGED BY THE
OFFICE OF THE SPECIAL TRUSTEE
FOR AMERICAN INDIANS**



United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

November 29, 2004

Memorandum

To: Special Trustee for American Indians
Office of the Special Trustee for American Indians

From: Roger La Rouché *Roger LaRouché*
Assistant Inspector General for Audits

Subject: Independent Auditors' Report on the Tribal and Other Trust Funds and Individual Indian Monies Trust Funds Financial Statements for Fiscal Years 2004 and 2003 Managed by the Office of the Special Trustee for American Indians. (Report No. Q-IN-OST-0066-2004)

The Office of the Special Trustee for American Indians (OST) contracted with KPMG LLP, (KPMG) an independent certified public accounting firm, to audit the OST's financial statements as of September 30, 2004, and for the year then ended. The OST's financial report contains separate financial statements and notes for Tribal and Other Trust Funds and Individual Indian Monies Trust Funds. The contract required that KPMG conduct its audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in the *Government Auditing Standards*, issued by the Comptroller General of the United States of America.

In its Independent Auditor's Report dated November 10, 2004, (Attachment) KPMG issued a qualified opinion on OST's financial statements because inadequacies in certain Department of the Interior trust related systems and processes made it impracticable to extend auditing procedures sufficiently to satisfy auditors as to the fairness of trust fund balances. Also, certain parties for whom OST holds monetary assets in trust (i) do not agree with balances recorded by OST, and certain of these parties have filed, or are expected to file, claims against the United States Government, or (ii) have filed a class action lawsuit for an accounting of the individuals' trust funds which may or may not lead to claims against the United States Government. KPMG identified three reportable conditions related to internal controls over financial reporting: (1) reliance by OST on processing of trust transactions at the Bureau of Indian Affairs; (2) unresolved financial reporting issues from current and prior periods; and (3) internal controls over information technology systems. KPMG considers the first two reportable conditions to be material weaknesses. With regard to tests of compliance with laws and regulations described in the Responsibilities section of the report, KPMG found no instances of noncompliance that are required to be reported under the *Government Auditing Standards*.



**TRIBAL AND OTHER TRUST FUNDS AND
INDIVIDUAL INDIAN MONIES TRUST FUNDS
MANAGED BY THE U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**



ANNUAL REPORT 2004

**TRIBAL AND OTHER TRUST FUNDS AND
INDIVIDUAL INDIAN MONIES TRUST FUNDS
MANAGED BY THE U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**

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ATTACHMENT 1

Letter from the Special Trustee

I am pleased to present the Office of the Special Trustee for American Indians' (OST) fiscal year 2004 audited financial statements. This letter provides you with specific information about what our office has accomplished throughout this past fiscal year as part of our efforts to help the Department of the Interior fulfill its fiduciary responsibilities to American Indians, Alaska Natives, and Tribes. Providing services to trust beneficiaries, either directly through outreach meetings or indirectly by streamlining the back room financial transaction processing, has remained a primary focus of OST.

This year's accomplishments reflect OST's increasingly complex and demanding workload. Our Indian Trust Management mission statement – to perform our fiduciary trust responsibilities to American Indian tribes, individual Indians, and Alaska Natives by incorporating a beneficiary focus and beneficiary participation while providing effective, competent, stewardship and management of trust assets – guides our day-to-day work.

The Department of the Interior (Interior) is committed to fulfilling its trust responsibilities to American Indians and Alaska Natives effectively and efficiently. It also is committed to providing excellent service to the beneficiaries of that trust. To fulfill its trust responsibilities effectively and efficiently, Interior through OST created an overall strategic plan to guide the design and implementation of the trust reform efforts. The Comprehensive Trust Management Plan (CTM) is the strategic plan that guides and describes the vision, goals, and objectives of trust reform and the operation of the trust program for all bureaus and offices within Interior.

The Interior published the CTM on March 28, 2003. Achieving the goals that are at the heart of the CTM will result in enhanced beneficiary services, ownership information, and administrative services; improved management of land and natural resource assets, and trust fund assets; and increased support for Indian self-governance and self-determination. The CTM also considers the trends that influence trust management, the role of relevant stakeholders, and the interaction of Interior agencies. OST supports its goal to fulfill Indian fiduciary trust responsibilities by implementing the following strategies:

Improve Indian Fiduciary Trust Beneficiary Services by routinely providing timely, accurate, understandable statements; providing convenient access to trust account services and information; developing and maintaining effective communications and facilitating beneficiary involvement in trust management; providing assistance to tribes in the management of trust assets; and working to increase the number of tribes that participate in cooperative audit programs for mineral leases.

Support Indian Self-Governance and Self-Determination by fostering expansion of self-governance compacts and self-determination contracts in a manner consistent with Interior's fiduciary responsibilities.

Improve Indian Trust Ownership and Other Information through prompt distribution of trust assets to heirs after Bureau of Indian Affairs (BIA) and Office of Hearing and Appeals (OHA) render probate decisions; and ensuring accuracy of integrity of data maintained in agency offices and account systems.

Manage Trust Fund Assets for Timely and Productive Use through managing and investing funds held in accounts on behalf of individual Indians and tribes; and, collecting, disbursing, and accounting for funds timely and accurately.

Improve Management of Land and Natural Resource Assets by obtaining appraisal information, as needed on trust and restricted lands for tribal and individual Indian owners; and overseeing implementation of the Indian Land Consolidation program to reduce the number of fractionated interests in land.

Below are some highlights of OST activities accomplished on behalf of the trust beneficiaries in fiscal year 2004:

- Established and hired Regional Fiduciary Trust Administrators to provide first-line supervision to trust officers and to collaborate with BIA to fulfill Interior's fiduciary responsibilities;
- Established and hired Fiduciary Trust Officers to provide a primary point of contact for trust beneficiaries and provide managerial presence to all field staff;


- Participated in implementation of an expanded performance audit by the Office of Inspector General to review collection of all funds to help ensure that appropriate management and internal controls are in place and being followed by all agencies collecting funds on behalf of IIM and tribal beneficiaries;
- Developed an archival and records management studies program at Haskell Indian Nations University through a Memorandum of Understanding signed by Secretary Norton with National Archives and Records Administration;
- Established a Memorandum of Understanding between the Office of Trust Records and BIA to formalize the partnership with regard to the management of general records used by BIA;
- Appointed the membership of the 2004-2006 Special Trustee's Advisory Board;
- Completed OST Information Technology systems certification and accreditation;
- Developed and began implementation of the Indian Trust Rating System to measure performance of fiduciary trust activities;
- Outsourced the investment management functions of the Individual Indian Monies investment pool, which includes the selection of investment securities and the execution of investment security trades;
- Received approval of the major components of the "To-Be" Trust Business model, now called the Fiduciary Trust Model, by Secretary Norton on August 11, 2004;
- Sent more than 395,000 checks to account holders;
- Distributed in excess of 500 million dollars to Tribal and Individual Indian beneficiaries;
- Conducted approximately 8,300 appraisals on parcels of Indian land;
- Provided funding of 42 million dollars to BIA for the acquisition of over 41,000 fractionated interests of land (approximately 40,000 acres) that were transferred to tribal ownership; and

- Assisted with the drafting of a new Indian Probate Code (S.1721) passed by Congress.

One of the biggest challenges we are facing is the continuation of the court-ordered disconnection from the Internet. In spite of the inaccessibility, OST has improved its ability to serve its trust beneficiaries. In keeping with the business objectives outlined in the CTM, OST will pursue the following initiatives during Fiscal Year 2005:

- Pilot a Beneficiary Call Center to be a resource for beneficiaries on fiduciary Indian trust issues;
- Implement a commercial lockbox process to speed deposits and provide timely receipt of funds;
- Pursue with beneficiaries increased use of direct deposit to provide more timely receipt of funds by the beneficiary and reduce potential risk of theft or loss of checks.
- Complete development of two trust training certification programs in conjunction with the Cannon Financial Institute; and
- Begin implementation of the Fiduciary Trust Model.

I hope you find this year's Annual Report informative and useful. We welcome your help, comments, or suggestions for continued improvement.


 Ross C. Swimmer
 Special Trustee for American Indians



ATTACHMENT 2



**TRIBAL AND OTHER TRUST FUNDS
MANAGED BY THE U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**

Financial Statements

September 30, 2004 and 2003

(With Independent Auditors' Report Thereon)



In accordance with *Government Auditing Standards*, we have also issued a separate report dated November 10, 2004, on our consideration of internal control over financial reporting and compliance with certain provisions of laws, regulations, and contracts of the Tribal and Other Trust Funds managed by OST. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

KPMG LLP

November 10, 2004

**TRIBAL AND OTHER TRUST FUNDS
MANAGED BY THE U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**

Statements of Assets and Trust Fund Balances – Cash Basis

September 30, 2004 and 2003

(in thousands)

Assets	2004	2003
Cash and cash equivalents (note 3)	\$ 490,380	507,578
Due from other Federal agencies (note 4)	7,800	—
Investments (note 5)	<u>2,477,052</u>	<u>2,372,434</u>
Total assets	<u>\$ 2,975,232</u>	<u>2,880,012</u>
Trust Fund Balances		
Held for Indian tribes (notes 7 and 9)	\$ 2,708,869	2,624,471
Held by the Department of the Interior and considered to be U.S. Government funds (note 7)	<u>266,363</u>	<u>255,541</u>
Total trust fund balances	<u>\$ 2,975,232</u>	<u>2,880,012</u>

See accompanying notes to financial statements.

**TRIBAL AND OTHER TRUST FUNDS
MANAGED BY THE U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**

Statements of Changes in Trust Fund Balances – Cash Basis

Years ended September 30, 2004 and 2003

(in thousands)

	<u>2004</u>	<u>2003</u>
Increases:		
Receipts	\$ 300,960	256,168
Interest received on invested funds	106,348	118,010
Gain on disposition of investments, net	<u>6,359</u>	<u>4,291</u>
	413,667	378,469
Decreases:		
Disbursements to and on behalf of Indian tribes and other trust funds and withdrawal of trust funds by Indian tribes (note 9)	<u>(318,447)</u>	<u>(354,746)</u>
Increase in trust fund balances, net	95,220	23,723
Trust fund balances, beginning of year	<u>2,880,012</u>	<u>2,856,289</u>
Trust fund balances, end of year (notes 7 and 9)	<u>\$ 2,975,232</u>	<u>2,880,012</u>

See accompanying notes to financial statements.

**TRIBAL AND OTHER TRUST FUNDS
MANAGED BY THE U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**

Notes to Financial Statements

September 30, 2004 and 2003

(1) Background and Description of the Trust Funds

(a) Overview of the Trust Funds

Establishment and Management of the Trust Funds – The legislation which authorizes the Secretary of the United States Department of the Interior (Secretary) to manage the Tribal and Other Trust Funds (Trust Funds) recognizes the unique trust relationship that exists between the Indian tribes, individual Indians, and the United States Government (U.S. Government). Agreements between the U.S. Government and the various Indian tribes, many of these in the form of treaties, recognize the sovereignty of tribes. During the course of the Nation's history and the U.S. Government's evolving policies toward Indian tribes, the trust relationship has retained characteristics based upon tribal sovereignty. The United States Congress has designated the Secretary as the primary fiduciary with responsibility for the monetary and nonmonetary resources held in trust on behalf of American Indian tribes, individual Indians, and other trust funds. In carrying out the management and oversight of the Indian trust assets, the Secretary has a fiduciary responsibility to ensure all monies are received for the use of Indian lands and the extraction of natural resources from Indian lands, disburse such monies collected to the appropriate beneficiaries, ensure that trust accounts are properly maintained and invested, and ensure that accurate and complete reports are provided to the trust beneficiaries in accordance with applicable law.

The balances that have accumulated in the Trust Funds have resulted generally from judgment awards, settlement of claims, land use agreements, royalties on natural resource depletion, other proceeds derived directly from trust resources, and investment income.

The accompanying financial statements include only the monetary balances held in trust by the Office of the Special Trustee for American Indians (OST) for trust beneficiaries and do not include (i) the operating account balances of OST (e.g., Fund Balance with Treasury, Property, Plant, and Equipment) or (ii) other Indian trust assets, including but not limited to, Indian lands, buildings, or other nonmonetary assets managed by the United States Department of the Interior (Department).

The Reform Act – The American Indian Trust Fund Management Reform Act of 1994 (Public Law 103-412) (the Reform Act) authorized the establishment of OST which is headed by the Special Trustee for American Indians (Special Trustee) who reports to the Secretary. Under this legislation, the Special Trustee is responsible for oversight, reform, and coordination of the policies, procedures, systems, and practices used by various bureaus and offices of the Department, including but not limited to the Bureau of Indian Affairs (BIA), the Minerals Management Service (MMS), and the Bureau of Land Management (BLM), in managing Indian trust assets.

2003 Reorganization – A reorganization of the Office of the Assistant Secretary – Indian Affairs, BIA, and OST became effective on April 21, 2003. Among the changes of the reorganization, responsibilities and authorities were updated, new positions were created, and new organizational charts for the Office of the Assistant Secretary – Indian Affairs, BIA, and OST were created.

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Notes to Financial Statements

September 30, 2004 and 2003

Office of the Special Trustee for American Indians – Indian trust assets, including the Trust Funds, are primarily managed under the delegated authority of OST and BIA. Management of Indian trust assets on behalf of the trust beneficiaries is dependent upon the processing of trust-related transactions within certain information systems of the Department, including but not limited to OST, BIA, MMS, and other Departmental bureaus and offices. BIA, MMS, and other Departmental bureaus and offices are responsible for managing the natural resources located within the boundaries of Indian reservations and trust lands as well as the processing of data regarding the ownership and leasing of Indian lands. The allocation and distribution of receipts and disbursements by OST to trust beneficiaries is significantly dependent and reliant upon the receipt of timely and accurate information derived from records maintained by BIA, MMS, and other Departmental bureaus and offices (see note 8).

Regional Offices – OST and BIA maintain staff at regional offices located throughout the United States, which provide administrative and operational support for their respective agency and field offices.

Agency and Field Offices – OST and BIA maintain staff at agency and field offices located throughout the United States, which are generally located near the tribes and individual Indians served. OST and BIA personnel located at most of the agency offices perform various functions related to trust fund activities. Each of the agency and field offices is organized under one of the regional offices.

(b) Description of the Trust Funds

Certain of the Trust Funds are subject to legal, regulatory, budgetary, court ordered, or other restrictions (see note 7). A brief description of the Trust Funds follows:

- **Tribal Trust Funds** – Approximately 1,400 accounts comprise the Tribal Trust Funds, which totaled approximately \$2,708,869,000 and \$2,624,471,000 as of September 30, 2004 and 2003, respectively.

Tribal Trust Funds realize receipts from a variety of sources, including judgment awards, settlement of claims, land use agreements, royalties on natural resource depletion, other proceeds derived directly from trust resources, and investment income.

- **Other Trust Funds** – Other Trust Funds are comprised of those funds classified as *Held by the Department of the Interior and considered to be U.S. Government funds* (see note 7). Other Trust Funds totaled approximately \$266,363,000 and \$255,541,000 as of September 30, 2004 and 2003, respectively.

Other Trust Funds realize receipts from a variety of sources including leases, rights of way, settlement of Indian claims, donations and bequests, and investment income.

**TRIBAL AND OTHER TRUST FUNDS
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Notes to Financial Statements

September 30, 2004 and 2003

(c) *Investment of Trust Funds*

Authorizing legislation and a substantial body of case law specify how Indian trust funds should be managed and which financial instruments constitute appropriate investments for Indian trust funds. The Trust Funds are invested in U.S. Government securities, including U.S. Department of the Treasury (U.S. Treasury) issues, U.S. Government agency issues, and U.S. Government-sponsored entity issues.

(2) *Summary of Significant Accounting Policies*

(a) *Basis of Accounting*

OST uses the cash basis of accounting for the Trust Funds, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The cash basis of accounting differs from accounting principles generally accepted in the United States of America in that receivables and payables are not accrued and premiums and discounts are not amortized or accreted. Receipts are recorded when received and disbursements are recorded when paid. Investments are stated at historical cost. Interest received on invested funds reported in the statements of changes in trust fund balances reflects interest received during the fiscal year.

(b) *Cash and Cash Equivalents*

Management considers all highly liquid financial instruments with maturities of three months or less when purchased to be cash equivalents.

(c) *Investments*

Investment securities at September 30, 2004 and 2003 consist of U.S. Treasury issues, U.S. Government agency issues, and U.S. Government-sponsored entity issues. Investment securities are recorded at historical cost. Interest income is recognized when received.

The Trust Funds' investments have a concentration of credit risk in U.S. Government securities, as mandated by 25 USC 162.

(d) *Receipts*

Receipts from various leasing activities, mineral royalties and sales of extracted minerals, timber and other forest products, fees and fines, and the granting of easements are generated from a variety of nonmonetary assets that are held in trust by the U.S. Government and managed by BIA and other Departmental bureaus and offices on behalf of tribes. Receipts on hand at the regional and agency offices at September 30, 2004 and 2003, if any, awaiting deposit to the U.S. Treasury are not included in the financial statements.

Receipts also include payments from the U.S. Government for judgment awards and the settlement of claims.

**TRIBAL AND OTHER TRUST FUNDS
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Notes to Financial Statements

September 30, 2004 and 2003

(e) Disbursements

Payments disbursed from the Trust Funds consist of accumulations of funds from various income-producing activities such as leasing, royalty receipts, minerals extraction, timber and other forest product sales, judgment awards, settlement of claims, and investment income. Under certain conditions, tribes disburse per capita payments to their enrolled members.

Public Law 103-412 specifically allows for the voluntary withdrawal of judgment awards and settlement of claims funds from the Trust Funds. Except where prohibited by statute, an Indian tribe may submit a plan to withdraw some or all funds held in trust for the tribe in accordance with 25 CFR 1200.

(f) Use of Estimates

The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of assets at the date of the financial statements and the reported amounts of increases and decreases in trust fund balances during the reporting period. Actual results could differ from those estimates.

(3) Cash and Cash Equivalents

Cash equivalents of approximately \$486 million and \$504 million at September 30, 2004 and 2003, respectively, consist primarily of overnight investments with the U.S. Treasury.

(4) Due From Other Federal Agencies

Due from other Federal agencies of \$7,800,000 as of September 30, 2004 represents an amount that the BIA erroneously transferred from the Trust Funds' account at the U.S. Treasury into the BIA's account at the U.S. Treasury. This amount was transferred on September 30, 2004 and was returned to the proper U.S. Treasury account in October of 2004. The erroneous transfer, which was discovered through OST's reconciliation and internal control process, did not impact the interest earnings to the Trust Funds as the Trust Funds continued to report and receive the appropriate interest on the full \$7,800,000.

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(5) Investments

The historical cost, gross unrealized holding gains, gross unrealized holding losses, and fair value of investment securities by major class of security at September 30, 2004 and 2003 were as follows (amounts exclude investments in U.S. Treasury overnight securities discussed in note 3):

	<u>Historical cost</u>	<u>Gross unrealized holding gains</u>	<u>Gross unrealized holding losses</u>	<u>Fair value</u>
		(in thousands)		
At September 30, 2004:				
U.S. Treasury and agency securities	\$ 2,393,690	90,229	(13,725)	2,470,194
Mortgage-backed securities	83,362	1,415	(206)	84,571
	<u>\$ 2,477,052</u>	<u>91,644</u>	<u>(13,931)</u>	<u>2,554,765</u>
At September 30, 2003:				
U.S. Treasury and agency securities	\$ 2,322,737	128,069	(6,639)	2,444,167
Mortgage-backed securities	49,697	2,897	(987)	51,607
	<u>\$ 2,372,434</u>	<u>130,966</u>	<u>(7,626)</u>	<u>2,495,774</u>

Gross unrealized holding gains and gross unrealized holding losses include amortization of discounts, accretion of premiums, and interest earned but not yet received. Maturities of investment securities were as follows at September 30, 2004:

	<u>Historical cost</u>	<u>Fair value</u>
	(in thousands)	
Due in one year or less	\$ 333,397	335,197
Due after one year through five years	1,085,269	1,095,001
Due after five years through ten years	484,887	537,704
Due after ten years	573,499	586,863
	<u>\$ 2,477,052</u>	<u>2,554,765</u>

(6) Commitments and Contingencies

Certain Indian tribes for whom OST holds monetary assets in trust do not agree with balances recorded by OST, and certain of these Indian tribes have filed, or are expected to file, claims against the U.S. Government for failure to fulfill its fiduciary responsibilities and for other related charges. Twenty-six tribal trust cases currently are pending in various Federal district courts and the U.S. Court of Federal Claims. The cases, which were brought by twenty different tribes, involve claims for trust fund and asset mismanagement, accounting, and other declaratory relief. A substantial number of the cases are stayed pending settlement negotiations. At least three cases are in advanced settlement negotiations, although no

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Notes to Financial Statements

September 30, 2004 and 2003

settlement agreements have been finalized to date. Neither OST nor the Office of the Solicitor for the Department can presently determine the outcome of these actions nor the total amount, responsibility, and funding source of the potential liability. Any settlement resulting from an adverse outcome of the contingencies described above is generally not expected to be satisfied with trust fund balances. No amounts have been accrued in the accompanying Trust Funds' financial statements for potential claims receivable from the U.S. Government.

(7) Trust Fund Balances

Trust fund balances are the aggregation of monetary assets held in trust and represent the amounts owed to beneficiaries as of September 30, 2004 and 2003 for which OST has a fiduciary responsibility.

The Trust Funds contain the following Trust Fund balance categories for U.S. Government budget purposes, which are reflected as separate components in the accompanying financial statements:

- *Held for Indian tribes* – These represent funds held on behalf of Indian tribes. These funds are considered non-Federal monies.
- *Held by the Department of the Interior and considered to be U.S. Government funds* – These represent funds, some of which will be transferred to the *Held for Indian tribes* category provided certain conditions are satisfied, and for others the corpus of the fund may be nonexpendable. These funds are considered U.S. Government monies.

A portion of trust fund balances represents estimated payments on production-type leases for which certain tribes and individual Indians hold an interest (see note 8). When any adjustments to production are identified, estimated payments in excess of production are returned to the depositor.

Included in the Trust Funds are certain balances which are presently not identified to specific Indian tribes because judgment awards were granted to several Indian tribes in a particular geographic area for settlement of claims related to certain lands.

(8) Related-Party Transactions With Other Government Organizations

(a) *U.S. Department of the Interior Bureau of Indian Affairs*

BIA is responsible for the collection of certain monies resulting from the management and use of Indian trust lands and other trust resources. In processing collections for deposit, certified Collection Officers must obtain trust accounting information from BIA program staff. Upon deposit of the trust funds, deposit and related trust accounting information is forwarded either manually or via electronic transfer to OST. Upon receipt, OST records the deposit of trust funds to trust accounts based on the information received from BIA.

(b) *U.S. Department of the Interior Minerals Management Service*

For certain trust leases, MMS is responsible for the collection of royalty payments on behalf of Indian tribes and individual Indians holding mineral rights. MMS deposits the royalty payments with

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the U.S. Treasury and electronically transfers to OST the related accounting information, generally the next business day.

The accounting information received from MMS provides OST an allocation of 100% tribally owned lease royalties, enabling OST to record trust deposits directly into tribal accounts. For tribally/individually co-owned leases, and individually owned leases, allocation and accounting data is forwarded to OST via electronic interface through the Royalty Distribution Reporting System that is maintained by BIA. Pursuant to established procedure and appropriate authorization, the data is recorded by OST. MMS and BLM both perform verification and other monitoring procedures of mineral assets. Oil and gas companies sometimes forward payments to MMS based on estimated mineral production in order to comply with the Federal Oil and Gas Royalty Management Act of 1982 that requires timely distribution of royalties. These estimated payments may be disbursed by OST to the beneficiaries. Typically, the oil and gas companies adjust future payments for excess or shortfall amounts, if any, based on actual production.

(c) Other

The U.S. Treasury holds cash and certain investments and disburses for OST.

The Department's Office of the Solicitor serves as legal counsel for OST.

(9) Transfers of Trust Funds

OST, pursuant to information provided by BIA, utilizes special deposit accounts maintained within the IIM Trust Funds for both tribal and IIM beneficiaries as suspense accounts whereby funds are temporarily posted when allocation information is not provided when the funds are received. Following receipt of allocation information from BIA, the funds are transferred from the special deposit accounts to the designated tribal and/or IIM account(s). Special deposit accounts totaled approximately \$46 million and \$59 million as of September 30, 2004 and 2003, respectively. In addition, certain per capita disbursements authorized by tribes result in transfers from the Tribal and Other Trust Funds to the IIM Trust Funds while certain oil and gas distributions may result in transfers from the IIM Trust Funds to the Tribal and Other Trust Funds. Net transfers of trust funds from the Tribal and Other Trust Funds to the IIM Trust Funds totaled approximately \$10.9 million and \$11.4 million during the years ended September 30, 2004 and 2003, respectively. These transfers are reflected as disbursements in the accompanying statements of changes in trust fund balances.

ATTACHMENT 3



**INDIVIDUAL INDIAN MONIES TRUST FUNDS
MANAGED BY THE U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**

Financial Statements

September 30, 2004 and 2003

(With Independent Auditors' Report Thereon)





KPMG LLP
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6565 Americas Parkway NE
PO Box 3990
Albuquerque, NM 87190

Independent Auditors' Report

The Special Trustee for American Indians

U.S. Department of the Interior Office of the Special Trustee for American Indians:

We have audited the accompanying statements of assets and trust fund balances of the Individual Indian Monies Trust Funds managed by the U.S. Department of the Interior Office of the Special Trustee for American Indians (OST) as of September 30, 2004 and 2003 and the related statements of changes in trust fund balances for the years then ended. These financial statements are the responsibility of management of OST. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as discussed in the fourth paragraph of this report, we conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in note 2, these financial statements were prepared on the modified cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

It was not practicable to extend our auditing procedures sufficiently to satisfy ourselves as to the fairness of trust fund balances in the accompanying financial statements as of September 30, 2004 and 2003 due to inadequacies in certain Department of the Interior trust-related systems and processes, which provide required trust financial information to OST. Trust fund balances enter into the determination of financial position and changes in trust fund balances. Certain parties for whom OST holds monetary assets in trust have filed a class action lawsuit for an accounting of the individuals' trust funds which may or may not lead to claims against the United States Government.

In our opinion, except for the effects on the financial statements of such adjustments, if any, as might have been determined to be necessary had we been able to apply adequate procedures to determine the fairness of trust fund balances and related changes in trust fund balances, as discussed in the preceding paragraph, the financial statements referred to in the first paragraph above present fairly, in all material respects, the financial position of the Individual Indian Monies Trust Funds managed by OST as of September 30, 2004 and 2003, and the changes in trust fund balances for the years then ended in conformity with the basis of accounting described in note 2.

In accordance with *Government Auditing Standards*, we have also issued a separate report dated November 10, 2004, on our consideration of internal control over financial reporting and compliance with certain provisions of laws, regulations, and contracts of the Individual Indian Monies Trust Funds managed by OST. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

KPMG LLP

November 10, 2004

**INDIVIDUAL INDIAN MONIES TRUST FUNDS
MANAGED BY U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**

Statements of Assets and Trust Fund Balances – Modified Cash Basis

September 30, 2004 and 2003

(in thousands)

Assets	2004	2003
Cash and cash equivalents (note 3)	\$ 21,373	26,488
Investments (note 4)	371,723	382,325
Accrued interest receivable	3,601	4,255
Total assets	\$ 396,697	413,068
Trust Fund Balances		
Held for individual Indians (notes 6 and 8)	\$ 396,697	413,068

See accompanying notes to financial statements.

**INDIVIDUAL INDIAN MONIES TRUST FUNDS
MANAGED BY THE U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**

Statements of Changes in Trust Fund Balances – Modified Cash Basis

Years ended September 30, 2004 and 2003

(in thousands)

	<u>2004</u>	<u>2003</u>
Increases:		
Receipts (note 8)	\$ 183,776	170,996
Interest earned on invested funds	20,216	22,817
Gain on disposition of investments, net	590	436
	<u>204,582</u>	<u>194,249</u>
Decreases:		
Disbursements to and on behalf of account holders	<u>(220,953)</u>	<u>(192,526)</u>
(Decrease) increase in trust fund balances, net	(16,371)	1,723
Trust fund balances, beginning of year	<u>413,068</u>	<u>411,345</u>
Trust fund balances, end of year (notes 6 and 8)	<u>\$ 396,697</u>	<u>413,068</u>

See accompanying notes to financial statements.

**INDIVIDUAL INDIAN MONIES TRUST FUNDS
MANAGED BY THE U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**

Notes to Financial Statements

September 30, 2004 and 2003

(1) Background and Description of the Trust Funds

(a) Overview of the Trust Funds

Establishment and Management of the Trust Funds – The legislation, which authorizes the Secretary of the United States Department of the Interior (Secretary) to manage the Individual Indian Monies Trust Funds (IIM Trust Funds), recognizes the unique trust relationship that exists between the Indian tribes, individual Indians, and the United States Government (U.S. Government). Agreements between the U.S. Government and the various Indian tribes, many of these in the form of treaties, recognize the sovereignty of tribes. During the course of the Nation's history and the U.S. Government's evolving policies toward individual Indians and Indian tribes, the trust relationship has retained characteristics based upon tribal sovereignty. The United States Congress has designated the Secretary as the primary fiduciary with responsibility for the monetary and nonmonetary resources held in trust on behalf of American Indian tribes, individual Indians, and other trust funds. In carrying out the management and oversight of the Indian trust assets, the Secretary has a fiduciary responsibility to ensure all monies are received for the use of Indian lands and the extraction of natural resources from Indian lands, disburse such monies collected to the appropriate beneficiaries, ensure that trust accounts are properly maintained and invested, and ensure that accurate and complete reports are provided to the trust beneficiaries in accordance with applicable law.

The balances that have accumulated in the IIM Trust Funds have resulted generally from settlement of claims, land use agreements, royalties on natural resource depletion, other proceeds derived directly from trust resources, receipt of judgment and tribal per capita distributions, and investment income.

The accompanying financial statements include only the monetary balances held in trust by the Office of the Special Trustee for American Indians (OST) for trust beneficiaries and do not include (i) the operating account balances of OST (e.g., Fund Balance with Treasury, Property, Plant, and Equipment) or (ii) other Indian trust assets, including but not limited to, Indian lands, buildings, or other nonmonetary assets managed by the United States Department of the Interior (Department).

The Reform Act – The American Indian Trust Fund Management Reform Act of 1994 (Public Law 103-412) (the Reform Act) authorized the establishment of OST which is headed by the Special Trustee for American Indians (Special Trustee) who reports to the Secretary. Under this legislation, the Special Trustee is responsible for oversight, reform, and coordination of the policies, procedures, systems, and practices used by various bureaus and offices of the Department, including but not limited to OST, the Bureau of Indian Affairs (BIA), the Minerals Management Service (MMS), and the Bureau of Land Management (BLM), in managing Indian trust assets.

2003 Reorganization – A reorganization of the Office of the Assistant Secretary – Indian Affairs, BIA, and OST became effective on April 21, 2003. Among the changes of the reorganization, responsibilities and authorities were updated, new positions were created, and new organizational charts for the Office of the Assistant Secretary – Indian Affairs, BIA, and OST were created.

**INDIVIDUAL INDIAN MONIES TRUST FUNDS
MANAGED BY THE U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**

Notes to Financial Statements

September 30, 2004 and 2003

Office of the Special Trustee for American Indians – Indian trust assets, including the IIM Trust Funds, are primarily managed under the delegated authority of OST and BIA. Management of Indian trust assets on behalf of the trust beneficiaries is dependent upon the processing of trust-related transactions within certain information systems of the Department, including but not limited to OST, BIA, MMS, and other Departmental bureaus and offices. BIA, MMS, and other Departmental bureaus and offices are responsible for managing the natural resources located within the boundaries of Indian reservations and trust lands as well as the processing of data regarding the ownership and leasing of Indian lands. The allocation and distribution of receipts and disbursements by OST to trust beneficiaries is significantly dependent and reliant upon the receipt of timely and accurate information derived from records maintained by BIA, MMS, and other Departmental bureaus and offices (see note 7).

Regional Offices – OST and BIA maintain staff at regional offices located throughout the United States which provide operational support for their respective agency and field offices.

Agency and Field Offices – OST and BIA maintain staff at agency and field offices located throughout the United States, which are generally located near the tribes and individual Indians served. OST and BIA personnel located at most of the agency offices perform various functions related to trust fund activities. Each of the agency and field offices is organized under one of the regional offices.

(b) Description of the Trust Funds

Certain of the IIM Trust Funds described below are subject to legal, regulatory, budgetary, court ordered, or other restrictions. Approximately 266,000 and 260,000 open accounts, held primarily for the benefit of individual Indian account holder beneficiaries and tribal entities, comprise the IIM Trust Funds as of September 30, 2004 and 2003, respectively. The IIM Trust Funds contain certain special deposit accounts for certain tribal and other entities.

The IIM Trust Funds are primarily funds on deposit for individual Indians with a beneficial interest in those funds. IIM account holders realize receipts primarily from settlement of claims, land use agreements, royalties on natural resource depletion, other proceeds derived directly from trust resources, judgment and tribal per capita distributions, and investment income.

(c) Investment of Trust Funds

Authorizing legislation and a substantial body of case law specify how Indian trust funds should be managed and which financial instruments constitute appropriate investments for Indian trust funds. The IIM Trust Funds are pooled and invested in U.S. Government securities, including U.S. Department of the Treasury (U.S. Treasury) issues, U.S. Government agency issues, and U.S. Government-sponsored entity issues.

**INDIVIDUAL INDIAN MONIES TRUST FUNDS
MANAGED BY THE U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**

Notes to Financial Statements

September 30, 2004 and 2003

(2) Summary of Significant Accounting Policies

(a) *Basis of Accounting*

OST uses the cash basis of accounting with certain modifications for the IIM Trust Funds, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Receipts are recorded when received with the exception of interest earned on invested funds (including discount accretion and premium amortization), and disbursements are recorded when paid. Investments are stated at amortized cost. Accrual adjustments to reflect interest earned but not received, and to record any applicable accretion of discounts and amortization of premiums over the terms of the investments, have been recorded in the accompanying financial statements. Interest income reported in the statements of changes in trust fund balances reflects interest earned, net of any premium amortization or discount accretion recognized during the fiscal year.

(b) *Cash and Cash Equivalents*

Management considers all highly liquid financial instruments with maturities of three months or less when purchased to be cash equivalents.

(c) *Investments*

Investment securities at September 30, 2004 and 2003 consist of U.S. Treasury issues, U.S. Government agency issues, and U.S. Government-sponsored entity issues. IIM Trust Funds are pooled and invested. Investment securities are recorded at amortized cost, adjusted for the amortization or accretion of premiums or discounts. Premiums and discounts are amortized or accreted over the life of the related investment security as an adjustment to yield using the effective-interest method. Interest income is recognized when earned.

The IIM Trust Funds' investments have a concentration of credit risk in U.S. Government securities, as mandated by 25 USC 162.

(d) *Receipts*

Receipts from various leasing activities, mineral royalties and sales of extracted minerals, timber and other forest products, fees and fines, and the granting of easements are generated from a variety of nonmonetary assets that are held in trust by the U.S. Government and managed by BIA and other Departmental bureaus and offices on behalf of individual Indians. Receipts on hand at the regional and agency offices at September 30, 2004 and 2003, if any, awaiting deposit to the U.S. Treasury are not included in the financial statements.

Receipts also include payments from the U.S. Government for judgment awards and the settlement of claims.

**INDIVIDUAL INDIAN MONIES TRUST FUNDS
MANAGED BY THE U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**

Notes to Financial Statements

September 30, 2004 and 2003

(e) Disbursements

Payments disbursed from the IIM Trust Funds consist of accumulations of funds from various income-producing activities such as leasing, royalty receipts, mineral extraction, timber and other forest product sales, judgment awards, tribal per capita distributions, and investment income.

(f) Use of Estimates

The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of assets at the date of the financial statements and the reported amounts of increases and decreases in trust fund balances during the reporting period. Actual results could differ from those estimates.

(3) Cash and Cash Equivalents

Cash equivalents of approximately \$19 million and \$25 million at September 30, 2004 and 2003, respectively, consist primarily of overnight investments with the U.S. Treasury.

(4) Investments

The amortized cost, gross unrealized holding gains, gross unrealized holding losses, and fair value of investment securities by major class of security at September 30, 2004 and 2003 were as follows (amounts exclude investments in U.S. Treasury overnight securities discussed in note 3):

	<u>Amortized cost</u>	<u>Gross unrealized holding gains</u>	<u>Gross unrealized holding losses</u>	<u>Fair value</u>
	(in thousands)			
At September 30, 2004:				
U.S. Treasury and agency securities	\$ 371,723	14,777	(1,487)	385,013
At September 30, 2003:				
U.S. Treasury and agency securities	\$ 382,325	26,178	(1,009)	407,494

**INDIVIDUAL INDIAN MONIES TRUST FUNDS
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OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**

Notes to Financial Statements

September 30, 2004 and 2003

Maturities of investment securities were as follows at September 30, 2004:

	<u>Amortized cost</u>	<u>Fair value</u>
	(in thousands)	
Due in one year or less	\$ 2,997	3,087
Due after one year through five years	157,824	158,693
Due after five years through ten years	64,085	73,420
Due after ten years	<u>146,817</u>	<u>149,813</u>
	<u>\$ 371,723</u>	<u>385,013</u>

(5) Commitments and Contingencies

Certain parties for whom OST holds monetary assets in trust have filed a class action lawsuit for an accounting of the individuals' trust funds which may or may not lead to claims against the U.S. Government. The lawsuit alleges that the Department and U.S. Treasury have breached their trust obligations with respect to management of funds in the IIM accounts. Neither OST nor the Office of the Solicitor for the Department can presently determine the outcome of these actions nor the total amount, responsibility, and funding source of the potential liability. Any settlement resulting from an adverse outcome of the contingencies described above is generally not expected to be satisfied with trust fund balances. No amounts have been accrued in the accompanying IIM Trust Funds financial statements for potential claims receivable from the U.S. Government.

(6) Trust Fund Balances

Trust fund balances are the aggregation of monetary assets held in trust and primarily represent the amounts owed to beneficiaries as of September 30, 2004 and 2003 for which OST has a fiduciary responsibility.

The net total of the balances reflected in the IIM account holders' subsidiary detail of accounts is less than the trust fund balances reported in the financial statements as of September 30, 2004 and 2003 due to certain cumulative differences.

As of September 30, 2004 and 2003, the aggregate sum of positive account balances in the IIM subsidiary detail of account holders' balances exceeds the trust fund balances reported in the financial statements by approximately \$6 million. As of September 30, 2004 and 2003, there are certain accounts with negative balances in the IIM account holders' subsidiary detail aggregating approximately \$44 million (of which approximately \$238,000 and \$233,000 is attributed to individual Indian accounts as of September 30, 2004 and 2003, respectively).

The subsidiary detail of IIM account balances contains approximately 20,000 special deposit accounts with balances totaling approximately \$46 million and \$59 million as of September 30, 2004 and 2003, respectively. A portion of the special deposit account monies held in the IIM Trust Funds has not been distributed because the ultimate disposition of the funds has not been determined.

**INDIVIDUAL INDIAN MONIES TRUST FUNDS
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Notes to Financial Statements

September 30, 2004 and 2003

The subsidiary detail of IIM account balances contains certain oil and gas holding accounts with balances totaling approximately \$7.0 million and \$6.1 million as of September 30, 2004 and 2003, respectively, which have not been distributed to beneficiaries. Upon receipt of the allocation and accounting data, provided by MMS and BIA, the monies will be distributed to IIM account holders' accounts (see note 7).

A portion of trust fund balances represents estimated payments on production-type leases for which certain individual Indians and tribes hold an interest (see note 7). When any adjustments to production are identified, estimated payments in excess of production are returned to the depositor.

(7) Related-Party Transactions With Other Government Organizations

(a) *U.S. Department of the Interior Bureau of Indian Affairs*

BIA is responsible for the collection of certain monies resulting from the management and use of Indian trust lands and other trust resources. In processing collections for deposit, certified Collection Officers must obtain trust accounting information from BIA program staff. Upon deposit of the trust funds, deposit and related trust accounting information is forwarded either manually or via electronic transfer to OST. Upon receipt, OST records the deposit of trust funds to trust accounts based on the information received from BIA.

(b) *U.S. Department of the Interior Minerals Management Service*

For certain trust leases, MMS is responsible for the collection of royalty payments on behalf of Indian tribes and individual Indians holding mineral rights. MMS deposits the royalty payments with the U.S. Treasury and electronically transfers to OST the related accounting information, generally the next business day. For tribally/individually co-owned leases, and individually owned leases, the allocation and accounting data to distribute the monies to the proper IIM account is forwarded to OST via electronic interface through the Royalty Distribution Reporting System that is maintained by BIA. Pursuant to established procedure and appropriate authorization, the data is recorded by OST. MMS and BLM both perform verification and other monitoring procedures of mineral assets. Oil and gas companies sometimes forward payments to MMS based on estimated mineral production in order to comply with the Federal Oil and Gas Royalty Management Act of 1982 that requires timely distribution of royalties. These estimated payments may be disbursed by OST to the beneficiaries. Typically, the oil and gas companies adjust future payments for excess or shortfall amounts, if any, based on actual production.

(c) *Other*

The U.S. Treasury holds cash and certain investments and disburses for OST.

The Department's Office of the Solicitor serves as legal counsel for OST.

**INDIVIDUAL INDIAN MONIES TRUST FUNDS
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Notes to Financial Statements

September 30, 2004 and 2003

(8) Transfers of Trust Funds

OST, pursuant to information provided by BIA, utilizes special deposit accounts maintained within the IIM Trust Funds for both tribal and IIM beneficiaries as suspense accounts whereby funds are temporarily posted when allocation information is not provided when the funds are received. Following receipt of allocation information from BIA, the funds are transferred from the special deposit accounts to the designated tribal and/or IIM account(s). Special deposit accounts totaled approximately \$46 million and \$59 million as of September 30, 2004 and 2003, respectively. In addition, certain per capita disbursements authorized by tribes result in transfers from the Tribal and Other Trust Funds to the IIM Trust Funds while certain oil and gas distributions may result in transfers from the IIM Trust Funds to the Tribal and Other Trust Funds. Net transfers of trust funds to the IIM Trust Funds from the Tribal and Other Trust Funds totaled approximately \$10.9 million and \$11.4 million during the years ended September 30, 2004 and 2003, respectively. These transfers are reflected as receipts in the accompanying statements of changes in trust fund balances.

ATTACHMENT 4



**TRIBAL AND OTHER TRUST FUNDS AND
INDIVIDUAL INDIAN MONIES TRUST FUNDS
MANAGED BY THE U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**

**Independent Auditors' Report on Internal Controls Over
Financial Reporting and on Compliance and Other Matters**

September 30, 2004

[REDACTED]



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Independent Auditors' Report on Internal Controls Over Financial Reporting and on Compliance and Other Matters

The Special Trustee for American Indians

U.S. Department of the Interior Office of the Special Trustee for American Indians:

We have audited the statements of assets and trust fund balances of the Tribal and Other Trust Funds as of September 30, 2004 and 2003, and the related statements of changes in trust fund balances for the years then ended, and the statements of assets and trust fund balances of the Individual Indian Monies Trust Funds as of September 30, 2004 and 2003, and the related statements of changes in trust fund balances for the years then ended (collectively referred to as the Trust Fund Financial Statements) managed by the U.S. Department of the Interior Office of the Special Trustee for American Indians (OST) and have issued our reports thereon dated November 10, 2004.

Our reports were qualified because it was not practicable to extend our auditing procedures sufficiently to satisfy ourselves as to the fairness of trust fund balances in the Trust Fund Financial Statements as of September 30, 2004 and 2003. Trust fund balances enter into the determination of financial position and changes in trust fund balances, and inadequacies in certain Department of the Interior trust-related systems and processes, which provide required trust financial information to OST, raise questions about the fairness of trust fund balances. Also, certain parties for whom OST holds monetary assets in trust have filed a class action lawsuit for an accounting of the individuals' trust funds which may or may not lead to claims against the United States Government, and other parties do not agree with the balances recorded by OST and have filed, or are expected to file, claims against the United States Government.

Our reports also state that the Trust Fund Financial Statements are prepared in accordance with a basis of accounting which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America as described in notes 2 to the Trust Fund Financial Statements. The objective of our audits was to express opinions on the fair presentation of the Trust Fund Financial Statements. In connection with our audits, we also considered OST's internal control over financial reporting and tested OST's compliance with certain provisions of applicable laws, regulations, and contracts that could have a direct and material effect on the Trust Fund Financial Statements.

Summary

Our consideration of internal control over financial reporting resulted in the following conditions being identified as reportable conditions:

- A. Reliance on processing of trust transactions at the Bureau of Indian Affairs
- B. Financial reporting – unresolved matters from current and prior periods
- C. Improve controls over information technology systems

We consider reportable conditions A. and B. above to be material weaknesses.

The results of our tests of compliance with the laws, regulations, and contracts described in the Responsibilities section of this report disclosed no instances of noncompliance with laws, regulations, and contracts that are required to be reported under *Government Auditing Standards*.

The following sections discuss our consideration of OST's internal control over financial reporting, the results of our tests of OST's compliance with certain provisions of applicable laws, regulations, and contracts, and management's and our responsibilities.

Internal Control Over Financial Reporting

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention that, in our judgment, relate to significant deficiencies in the design or operation of internal control over financial reporting and could adversely affect OST's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Overview – Trust Fund Financial Statements

The financial information systems and internal control procedures used in the processing of Indian trust transactions have suffered historically from a variety of system and procedural internal control weaknesses. In addition, current management is burdened with the ongoing impact of decades of accumulated discrepancies in the accounting records.

The United States Congress has designated the Secretary of the Department of the Interior (the Secretary) as the primary fiduciary with responsibility for the monetary and nonmonetary resources held in trust on behalf of American Indian tribes, individual Indians, and other trust funds. In carrying out the management and oversight of the Indian trust assets, the Secretary has a fiduciary responsibility to ensure all monies are received for the use of Indian lands and the extraction of natural resources from Indian lands, disburse such monies collected to the appropriate beneficiaries, ensure that trust accounts are properly maintained and invested, and ensure that accurate and complete reports are provided to the trust beneficiaries in accordance with applicable law.

The American Indian Trust Fund Management Reform Act of 1994 (Public Law 103-412) (the Reform Act) authorized the establishment of OST which is headed by the Special Trustee for American Indians (Special Trustee) who reports to the Secretary. Under this legislation, the Special Trustee is responsible for oversight, reform, and coordination of the policies, procedures, systems, and practices used by various bureaus and offices of the Department of the Interior (Department), including but not limited to OST, the Bureau of Indian Affairs (BIA), the Minerals Management Service (MMS), and the Bureau of Land Management (BLM), in managing Indian trust assets.

A reorganization of the Office of the Assistant Secretary – Indian Affairs, BIA, and OST, became effective on April 21, 2003. Among the changes of the reorganization, responsibilities and authorities were updated, new positions were created, and new organizational charts for the Office of the Assistant Secretary – Indian Affairs, BIA, and OST were created.

Indian trust assets, including the Trust Funds, are primarily managed under the delegated authority of OST and BIA. Management of Indian trust assets on behalf of the trust beneficiaries is dependent upon the processing of trust-related transactions within certain information systems of the Department, including but not limited to OST, BIA, MMS, and other Departmental bureaus and offices. BIA, MMS, and other Departmental bureaus and offices are responsible for managing the natural resources located within the boundaries of Indian reservations and trust lands as well as the processing of data regarding the ownership and leasing of Indian lands. The allocation and distribution of receipts and disbursements by OST to trust beneficiaries is significantly dependent and reliant upon the receipt of timely and accurate information derived from records maintained by BIA, MMS, and other Departmental bureaus and offices.

We noted certain matters involving internal control over financial reporting and its operation that we consider to be reportable conditions. We believe that the following reportable conditions are material weaknesses:

A. Reliance on Processing of Trust Transactions at the Bureau of Indian Affairs

Condition

Indian trust assets, including the trust funds, are primarily managed under the delegated authority of OST and BIA. Management of Indian trust assets on behalf of the trust beneficiaries is dependent upon the processing of trust related transactions within certain information systems of the Department, including but not limited to OST, BIA, MMS, and certain other Departmental bureaus and offices. BIA, MMS, and other Departmental bureaus and offices are responsible for managing the natural resources located within the boundaries of Indian reservations and trust lands as well as the processing of data regarding the ownership and leasing of Indian lands. The allocation and distribution of receipts and disbursements by OST to trust beneficiaries is significantly dependent and reliant upon the receipt of timely and accurate information derived from the records of the ownership and leasing of Indian land maintained by BIA, MMS, and other Departmental bureaus and offices.

The independent auditors' report on internal control over financial reporting and compliance and other matters for the year ended September 30, 2004 at BIA contained a reportable condition, which was considered a material weakness, in connection with controls over Indian trust transactions. The presence of this material weakness directly impacts OST's ability to process monetary trust transactions on behalf of trust beneficiaries and to provide accurate information to account holders due to the interrelationship between BIA and OST.

BIA performs a critical role in the initial input and subsequent changes to Indian trust financial information in its various regional and agency offices. Weaknesses in the following areas were noted:

- a. *Trust Fund Systems* - BIA has not consistently implemented automated systems for tracking and processing Indian trust fund activities. Agency offices use "off-the-shelf" software, internally developed software, in-house databases, and manual processes to manage ownership records, track lease activity, account for receivables/revenue, and determine disbursement amounts. BIA has developed an automated system, however, BIA has not yet implemented this new system in all agency offices. This situation increases the risk of inaccurate and untimely disbursements to Indian trust fund accounts.
- b. *Segregation of Duties* - The responsibilities for Indian trust fund processing are not properly segregated to prevent or detect errors. BIA did not segregate realty and land management

activities (i.e., lease compliance) from accounting activities (i.e., collecting, depositing, recording, and distributing receipts). Also, in some locations, the same employee was responsible for all activities associated with trust transactions, including initiating lease agreements, generating billings, collecting funds, making deposits, sending instructions to OST to create accounts, and distributing funds.

- c. Accounts Receivable - BIA has not developed and communicated standardized policies and procedures for establishing, tracking, and pursuing accounts receivable for the Indian trust funds. This has resulted in inconsistent processes and has increased the risk that amounts due to Indian trust funds are not identified and ultimately collected. Several agency offices prepared bills subsequent to receiving payments rather than preparing and sending bills in advance of the payment due date. In addition, certain agency offices do not identify and pursue past due receivables and instead rely on landowners/lessors to inquire of overdue payments before pursuing the receivable. Furthermore, several agency offices did not maintain a listing of leases and permits against which receivables could be established.
- d. Probate Backlog - BIA does not enter probate orders for land title into the trust management systems timely. Although BIA has made progress in reducing the backlog, BIA still has probate orders that have not been recorded. This increases the potential for inaccurate and untimely distributions of income to the Indian trust fund account holders.
- e. Untimely Deposits - Several agency offices did not consistently forward trust receipts to OST in a timely manner. In certain agency offices, deposits of trust receipts were delayed for up to five business days, and in others, delays were between six and ten days. Finally, though rare, certain agency offices took up to 16 business days to deposit receipts.
- f. Supervised and Restricted Accounts - BIA has not developed and implemented standardized procedures, training, and forms to manage supervised accounts in accordance with legislation. In addition, BIA did not consistently maintain documentation for supervised accounts, including social service assessment and evaluation forms, disbursement documentation, annual review documentation, court orders, and notification of restriction letters. Furthermore, BIA did not consistently perform annual reviews of accounts or prepare distribution plans for inactive accounts.
- g. Appraisal Compacts - One of the key elements in performing realty trust transactions is the requirement to obtain appraisals for realty transactions. Current laws allow the appraisal function to be compacted to tribes, who are often the named parties involved in realty transactions. BIA is responsible for assisting trust beneficiaries in the negotiation and execution of realty transactions. Office of Appraisal Services (OAS) is responsible for conducting reviews of appraisals that are completed for the benefit of tribes or individual trust beneficiaries. Controls are not in place to ensure that all appraisals, conducted under compacts or contracts completed for the benefit of tribes or individual trust beneficiaries are provided to OAS.

Recommendation

We recommend management continue to work collaboratively with the BIA to correct the weaknesses identified above such that OST may fulfill its fiduciary responsibility to the trust fund beneficiaries.

Management's Response

OST concurs, recognizes and acknowledges that, as reported, its ability to process (i.e., account for) trust funds receipts and disbursements for trust beneficiaries is significantly dependent and critically reliant upon the financial information derived from trust records that are maintained and provided by BIA. OST also shares in concerns regarding the integrity of the trust data it receives from BIA and understands the reportable condition reported as a material weakness in BIA's independent auditors' report on internal control over financial reporting and compliance and other matters. OST remains committed to work collaboratively with BIA towards trust management reform.

B. Financial Reporting – Unresolved Matters From Current and Prior Periods

Condition

As of September 30, 2004, several significant financial reporting differences from current and prior periods have not been resolved. The presence of these unresolved differences has a material effect on the Trust Fund Financial Statements as of September 30, 2004 and 2003 and for the years then ended. These matters include the following:

Investments – Lack of Reliable IIM Balance Available for Investing – IIM

The Trust Funds Accounting System (TFAS) control account for Individual Indian Monies (IIM) account holders is purported to represent the aggregate net balance of trust funds held on behalf of IIM account holders as reflected in the detailed subsidiary ledger of IIM accounts (subsidiary ledger) also in TFAS. The balance per the control account does not agree to the sum of the balances per the subsidiary ledger and it cannot be determined which balance, if either, is correct. Consequently, the balance of funds invested for IIM account holders may not be correct. The amount invested for IIM is based on the IIM control account balance in TFAS. As of September 30, 2004 and 2003, the aggregate sum of all positive balances included in the subsidiary ledger exceeded the control account by approximately \$6,000,000. Accordingly, IIM account holders with positive balances may be penalized by lower interest earnings. In addition, as of September 30, 2004 and 2003, the subsidiary ledger contains negative account balances totaling approximately \$44,300,000 (of which approximately \$238,000 and \$233,000 is attributed to individual Indian accounts as of September 30, 2004 and 2003, respectively).

Trust Fund Balances – Tribal and IIM

A historical "Undistributed Interest Account" of approximately \$1,800,000 existed at September 30, 1995. The balances as of September 30, 2004 and 2003 are approximately \$1,756,000 and \$1,738,000, respectively. Currently, the proper recipients of these funds have not been determined.

Cash – Tribal

As of September 30, 2004 and 2003, there were 12 accounts in TFAS with negative balances totaling approximately \$724,000 carried forward from the previous trust funds accounting system prior to the conversion to TFAS.

Special Deposit Accounts – Inconsistent Practices – IIM

As of September 30, 2004 and 2003, there were approximately 20,000 special deposit accounts reflected in the subsidiary ledger in TFAS with balances totaling approximately \$46 million and \$59 million, respectively. In accordance with Title 25 of the Code of Federal Regulations and as directed by BIA, OST records receipts into special deposit accounts within the subsidiary ledger when the

recipient trust fund account is unknown at the time of receipt. When BIA identifies the trust fund account(s), OST transfers the amount from the special deposit account(s) to the designated trust fund account(s) in accordance with BIA instructions. A significant number of special deposit accounts have remained inactive for the past several years and new accounts continued to be established during the years ended September 30, 2004 and 2003. During fiscal years 2002 and 2001, we understand management of OST, together with BIA and a contractor, developed and put in place a formal plan to address special deposit accounts. Beginning in fiscal year 2003, the Office of Historical Trust Accounting began working with OST and BIA to distribute funds in special deposit accounts that were opened on or before December 31, 2002. Special deposit account activity after that date will be addressed by BIA, with instructions for distributions being provided to OST. At September 30, 2004, a significant number of special deposit accounts continue to require resolution and management anticipates that these accounts will be reconciled by the beginning of fiscal year 2007.

Trust Fund Balances – IIM

During fiscal years 2002 and 2004, approximately \$922,000 and \$375,000, respectively, was transferred from certain special deposit accounts to “undistributed interest” house accounts in connection with the review of certain special deposit accounts performed by OST, together with BIA and a contractor. At September 30, 2004, these funds remain in the house accounts, as the proper recipients of the funds have not been determined. The funds are currently being invested with interest earnings allocated to current IIM account holders.

Recommendation

We recommend that management of OST continue to work to resolve these matters as soon as practicable. In situations where actions or inputs from Department officials are needed to resolve a matter, we recommend management of OST continue to work with appropriate Department officials such that all matters are resolved as soon as practical.

Management's Response

Management concurs, and during fiscal year 2005 plans to:

1. Continue to pursue funding to address the finding related to the IIM imbalance,
2. Reconcile and propose corrective entries for the Undistributed Interest account, and
3. In conjunction with the reconciliation of the Undistributed Interest account, propose corrective entries for the 12 accounts in TFAS with negative balances.

The balances in the Special Deposit Accounts are planned to be resolved through the following combined effort:

1. The Office of Historical Trust Accounting is responsible for working with the BIA to resolve the balances established prior to January 1, 2003,
2. The proactive coordination between BIA and OST to track and timely distribute current balances is in effect for post January 1, 2003 transactions, and
3. Implementing Fiduciary Trust Model efforts to significantly limit the need for Special Deposit Accounts.

We noted the following reportable condition that is not considered to be a material weakness:

C. Improve Controls Over Information Technology Systems

Condition

Sufficient internal control over IT systems and applications is necessary to ensure OST fulfills its fiduciary responsibility to trust beneficiaries and accomplishes its mission. During our audits, we noted certain matters related to internal control over IT that could be improved as indicated below.

Segregation of Duties – DADS Application

Segregation of duties between the programming, maintenance, and production environments of applications is necessary to maintain proper controls over the potential for unauthorized changes to production code as well as the processing of unauthorized transactions. During fiscal year 2003, management developed and implemented procedures whereby the DADS application programmer was instructed to no longer enter or process per capita disbursement transactions via the application. However, during the current year, we noted three instances where the DADS programmer processed live per capita disbursement transactions. In addition, the DADS programmer failed to notify management prior to performing these actions, and as a result, no provisions were made for additional supervision, review, or approval.

Access Controls

Procedures are not sufficient to ensure that TFAS access is removed in a timely manner for all terminated employees. In connection with our testwork, we noted two terminated employees remained on the current TFAS user access lists. However, both accounts were automatically disabled 90 days after termination date as a result of non-activity.

Security Office Function

Processes within OST are not sufficient to ensure that favorable screenings and background investigations are obtained for individuals with access to Trust data. Specifically, OST did not establish processes to monitor the performance of the MMS Security Office to ensure that background investigations had been initiated on employees with favorable screenings, or to identify background investigations that were in process, completed, expired, or adjudicated. As a result, we noted the following:

- Inconsistencies were noted between the background investigation and favorable screening information contained in the MMS database and the corresponding information contained in the FPPS database. As a result of these inconsistencies, the status of favorable screenings, background investigations, and adjudications could not be accurately determined.
- OST could not provide supporting documentation verifying completed background investigations had been received for 45 individuals. The hard copy forms necessary to obtain favorable screenings for background investigations were also unavailable.
- Favorable screenings were granted without background investigations being initiated for six individuals.
- Users granted access prior to July 2002 were allowed to retain system access provided the database indicated that a security credential had been issued. However, a process to ensure that

the security credentials were current and/or appropriate to the security risk associated with accessing Trust data was not established.

Recommendation

We recommend that OST management:

- Re-emphasize segregation of duties with personnel and implement a monitoring control by creating and reviewing a report identifying transactions processed by programmers on a periodic basis (monthly or quarterly).
- Remove individuals responsible for the development and maintenance of the DADS software from any per capita disbursement file distribution lists.
- Compare terminated employees to active user lists on a periodic basis (monthly or quarterly).
- Re-emphasize the importance of notifying the Office of the Chief Information Officer of terminations in a timely manner.
- Designate a primary database listing all employees and the current status of their background investigations, validate the information in that database, and design procedures to keep the information in the database updated.
- Develop a monitoring control to follow-up on the status of background investigations and favorable screenings on a periodic basis to ensure background investigations and favorable screenings are consistent with established policy. The results of these periodic updates should then be communicated to the appropriate level of management.

Management's Response

Management concurs, and during fiscal year 2005 plans to:

1. Move the per capita distribution posting process to the Office of Trust Services/Office of Trust Funds Management by December 31, 2004.
2. Initiate, through the Office of the Chief Information Officer, a dialog with MMS Personnel to receive a periodic report listing all OST terminations. A similar request will be made to the Bureau of Indian Affairs Personnel Office.

In addition, during fiscal year 2005, OST has assumed the responsibility for background investigations by creating and staffing a dedicated Security Office. The OST Security Office will produce monthly tracking reports for management review. Further, OST has commenced taking the appropriate steps to ensure that investigations are initiated on the six individuals listed.

A summary of the status of prior-year reportable conditions is included as Exhibit I. We also noted other matters involving internal control over financial reporting and its operation that we have reported to OST management in a separate letter dated November 10, 2004.

Compliance With Laws, Regulations, and Contracts

The results of our tests of compliance described in the Responsibilities section of this report disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We also noted other matters involving compliance with laws, regulations, and contracts that, under *Government Auditing Standards*, were not required to be included in this report, that we have reported to OST management in a separate letter dated November 10, 2004.

Responsibilities

Management's Responsibility

The American Indian Trust Fund Management Reform Act of 1994 requires that the Secretary shall cause to be conducted an annual audit on a fiscal year basis of all funds held in trust by the U.S. for the benefit of an Indian tribe or an individual Indian which are deposited or invested pursuant to the Act of June 24, 1938 (25 U.S.C. 162a).

Management is responsible for:

- Preparing the financial statements in conformity with the basis of accounting described in notes 2 of the Trust Fund Financial Statements;
- Establishing and maintaining internal controls over financial reporting; and
- Complying with laws, regulations, and contracts.

In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies. Because of inherent limitations in internal control, misstatements, due to error or fraud may nevertheless occur and not be detected.

Auditors' Responsibility

Our responsibility is to express opinions on the Trust Fund Financial Statements managed by OST based on our audits. Except as discussed in the fourth paragraph of our auditors' reports, we conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the U.S. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- Assessing the accounting principles used and significant estimates made by management; and
- Evaluating the overall financial statement presentation.

We believe that our audits provide a reasonable basis for our opinions.

In planning and performing our audits, we considered OST's internal control over financial reporting by obtaining an understanding of OST's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards*. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982. The objective of our audits was not to provide

assurance on internal controls over financial reporting. Consequently, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether the Trust Fund Financial Statements are free of material misstatement, we performed tests of OST's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, and contracts applicable to OST. Providing an opinion on compliance with laws, regulations, and contracts was not an objective of our audits, and accordingly, we do not express such an opinion.

Distribution

This report is intended for the information and use of the Department's management, the Department's Office of Inspector General, Office of Management and Budget, the Government Accountability Office, and the U.S. Congress, and is not intended to be, and should not be, used by anyone other than these specified parties.

KPMG LLP

November 10, 2004

**TRIBAL AND OTHER TRUST FUNDS AND
INDIVIDUAL INDIAN MONIES TRUST FUNDS
MANAGED BY THE U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS**

Status of Reportable Conditions, Reported as of September 30, 2003

September 30, 2004

Ref	Condition	Current-Year Status
OST-2003-A	Reliance on Processing of Trust Transactions at the Bureau of Indian Affairs	Repeated, with certain modifications in current-year report – see reportable condition A, considered a material weakness.
OST-2003-B	Financial Reporting – Unresolved Matters from Prior Periods	Repeated, with certain modifications in current-year report – see reportable condition B, considered a material weakness.
OST-2003-C	Improve Controls over Information Technology Systems	Repeated, with certain modifications in current-year report – see reportable condition C.

Status of Reportable Conditions, Reported as of September 30, 2002

September 30, 2004

Ref	Condition	Current-Year Status
OTFM-2002-A	Reliance on Processing of Trust Transactions at the Bureau of Indian Affairs	Repeated, with certain modifications in current-year report – see reportable condition A, considered a material weakness.
OTFM-2002-B	Financial Reporting – Unresolved Matters from Current and Prior Periods	Repeated, with certain modifications in current-year report – see reportable condition B, considered a material weakness.
OTFM-2002-C	Improve Controls over Information Technology Systems	Repeated, with certain modifications in current-year report – see reportable condition C.